

establishment of an effective national machinery in the form of a central policy-coordinating bureau would help to bridge the gap between international standards and domestic reality.

Until that time, however, the impact of the CEDAW Convention in Hong Kong will come from a bottom-up trajectory. Principles of equality begin with individual behaviour. As societies progress and develop, people change. Deeply-held traditional assumptions about the roles of men and women and the organization of society change, even as methods of production and communication change.

No single United Nations convention or international process can create a fair, just society. To have a vision of that which is just, however, does create momentum towards the achievement of that goal. The CEDAW process does just that. It helps to create an environment in which governments must account for their treatment of its citizenry, and it raises an awareness of what it means to incorporate democratic norms and policies into practical governmental programmes. That dynamic can be a powerful one, and it provides opportunities for and encouragement to the many people throughout the world who continue to believe in equality and work towards the realization of a society free of discrimination against any of its members.

Moana Erickson and Andrew Byrnes***

When Government Intervenes: Winding Up Fraudulent Companies in Hong Kong

Introduction

Most corporate insolvencies in Hong Kong are commenced by a creditor on the ground that the debtor company is unable to pay its debts. However, each year a small number of liquidations are commenced by a regulatory authority or a government official — namely, the Registrar of Companies, the Financial Secretary, the Securities and Futures Commission (the 'SFC'), or the Insurance Authority — against companies that are allegedly engaged in illegal or fraudulent activities. These filings are made on 'public interest', unfair prejudice, or other statutory grounds, irrespective of whether insolvency can be proved. Allowing regulatory authorities or government officials to intervene against

* Henry Luce Scholar (1998-99), Centre for Comparative and Public Law, Faculty of Law, The University of Hong Kong

** Associate Professor, and Director, Centre for Comparative and Public Law, Faculty of Law, The University of Hong Kong

companies through the filing of winding-up petitions is an important statutory remedy that is intended to deter companies from engaging in wrongful or fraudulent behaviour.¹

The existing statutory framework for the commencement of liquidations by regulatory authorities and government officials is quite complicated because the relevant statutory provisions are not consolidated in a single ordinance. Rather, the commencement procedures are located in the Companies Ordinance,² the Securities and Futures Commission Ordinance,³ the Leveraged Foreign Exchange Trading Ordinance,⁴ the Banking Ordinance,⁵ and the Insurance Companies Ordinance.⁶ Once a case is commenced, the liquidation is carried out pursuant to the winding-up procedures in the Companies Ordinance and the Companies (Winding-up) Rules, subject to any exceptions contained in the relevant legislation. This article provides an overview and analysis of this statutory structure and suggests how it could be improved.

For purposes of comparison, the first part of this article briefly sets out the procedures in the Companies Ordinance for the winding up of companies by the court. The second part discusses the commencement procedures used by government officials and regulatory authorities to file winding-up petitions against fraudulent companies. This section also highlights recent cases, sets out additional or alternative remedies that may be used against companies engaging in fraudulent activity, and considers relevant law reform proposals. The third part then discusses the appointment of, and the role to be played by, provisional liquidators in such cases.

The general procedures in the Companies Ordinance for the winding up of companies by the court

Hong Kong companies (primarily companies 'formed and registered' under Part I of the Companies Ordinance and which the Ordinance calls 'registered' companies) are wound up under Part V of the Companies Ordinance. 'Unregistered' companies (which include foreign companies and overseas companies registered under Part XI of the Companies Ordinance) are wound up under Part X of the Companies Ordinance.⁷

¹ See *Report of the Review Committee on Insolvency Law and Practice in the United Kingdom*, Cmnd 8558 (London: Her Majesty's Stationery Office, June 1982), under the Chairmanship of Sir Kenneth Cork, GBE, paras 1745-51, pp 392-3 (the *Cork Report*).

² Cap 32.

³ Cap 24.

⁴ Cap 451.

⁵ Cap 155.

⁶ Cap 41.

⁷ For a discussion of the winding up of unregistered companies in Hong Kong, see Charles D Booth, 'Living in Uncertain Times: The Need to Strengthen Hong Kong Transnational Insolvency Law' (1996) 34 *Columbia Journal of Transnational Law* 389 ('Living in Uncertain Times'); and Charles D Booth, 'The Transnational Aspects of Hong Kong Insolvency Law' (1995) 2 *Southwestern Journal of Law and Trade in the Americas* 1.

Section 177(1) of the Companies Ordinance provides that a Hong Kong company may be wound up by the court⁸ if —

- (a) the company has by special resolution resolved that the company be wound up by the court;
- (b) the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;
- (c) the number of its members is reduced below 2;
- (d) the company is unable to pay its debts;
- (e) the event, if any, occurs on the occurrence of which the memorandum or articles provide that the company is to be dissolved;
- (f) the court is of opinion that it is just and equitable that the company should be wound up.

Section 179(1) of the Companies Ordinance provides that a winding-up petition may be presented by a variety of parties, including the company itself, any creditor or creditors (including any contingent or prospective creditor or creditors), or contributory or contributories (or the trustee in bankruptcy or the personal representative of a contributory).⁹ However, the typical petitioner is an unsecured creditor relying on s 177(1)(d) of the Companies Ordinance and the inability of a company to satisfy a s 178 statutory demand. Section 178 of the Companies Ordinance defines the inability of a company to pay its debts to a creditor and includes both a cash flow and a balance sheet test. Section 178(1)(a) provides that a company shall be deemed to be unable to pay its debts, *inter alia*, if it fails to comply within three weeks with a statutory demand for a sum exceeding HK\$5,000.

A petitioner listed in s 179 may rely on the just and equitable ground in s 177(1)(f) as a ground for petitioning, *inter alia*, for the winding up of a company that is engaging in fraudulent or illegal activities. For example, courts have ordered a company to be wound up on this ground: (1) where a company was

⁸ A Hong Kong company may also be wound up through a voluntary winding up (a winding up without a court order). See Companies Ordinance, ss 228-257. A voluntary winding up of a solvent company proceeds as a members' voluntary winding up (see *ibid*, ss 234-239A) and of an insolvent company, as a creditors' voluntary winding up (see *ibid*, ss 240-248). Whether a voluntary winding up proceeds as a members' voluntary winding up or as a creditors' voluntary winding up depends on whether the directors are able to make a statutory declaration that the company will be able to pay its debts in full within twelve months of the commencement of the winding up. See *ibid*, s 233.

Most voluntary windings up proceed as members' voluntary windings up, and thus involve the liquidation of solvent companies. For example, in 1998, 3,005 members' voluntary windings up and 211 creditors' voluntary windings up were commenced and in 1999, 3,067 members' voluntary windings up and 322 creditors' voluntary windings up. Companies Registry website at <http://www.info.gov.hk/cr/key/index.htm>. However, the great majority of liquidations of insolvent companies proceed as compulsory liquidations. For example, in 1998, 946 compulsory winding-up petitions were presented and 723 winding-up orders were made, and in the first eleven months of 1999, 1,057 winding up petitions were presented and 695 winding-up orders were made. Official Receiver's Office website at <http://www.info.gov.hk/oro/statis.htm>.

⁹ Section 179(1)(a) of the Companies Ordinance sets out further conditions for a petition filed by a contributory and s 179(1)(c), for a petition by a contingent or prospective creditor. Section 179(2) also enables the Official Receiver to file a petition where a company is being wound up voluntarily.

formed to carry out fraud or an illegal purpose;¹⁰ or (2) where management's conduct called for an investigation, including where the facts of suspicious conduct had been concealed from the shareholders or where persons guilty of fraud had controlled a company.¹¹

The ability of regulatory authorities and government officials to commence liquidation proceedings against companies engaged in illegal or fraudulent activities irrespective of whether insolvency can be proved

The Companies Ordinance empowers the Registrar of Companies and the Financial Secretary to petition for the winding up of companies under defined circumstances irrespective of whether insolvency can be proved. Similar powers are given to the Financial Secretary and regulatory authorities by the Securities and Futures Commission Ordinance, the Leveraged Foreign Exchange Trading Ordinance, the Banking Ordinance, and the Insurance Companies Ordinance. Of the hundreds of compulsory liquidations per year, normally only a handful are commenced by government officials and regulatory authorities.

Ability of the Registrar of Companies to petition for the winding up of companies under the Companies Ordinance

Section 179(1)(e) of the Companies Ordinance provides that the Registrar of Companies may present a winding-up petition on any of the six grounds set out in s 177(1)(c) and (2) of the Companies Ordinance. Four of these grounds involve a company's non-compliance with certain basic company law obligations,¹² rather than its engaging in illegal or fraudulent activities, and therefore fall outside the scope of this article. However, the two other grounds are relevant to the winding up of fraudulent companies. Section 177(2) provides that on an application by the Registrar to wind up a company, the company may be wound up by the court if it appears to the court as follows:

- (a) that the company is being carried on for an unlawful purpose or any purpose lawful in itself but one which cannot be carried out by a company; or

...

¹⁰ See Roman Tomasic & ELG Tyler, *Hong Kong Company Law: Legislation and Commentary* (Hong Kong: Butterworths, 1998-), para [9203], p 2,852 (citing *Re TE Brinsmead & Sons Ltd* [1897] 1 Ch 406 (setting up by former employees of a rival business with a similar name with the intention to pass off the new business as the old); *Re International Securities Corp Ltd* (1908) 25 TLR 31; *R v Registrar of Companies, Ex parte Attorney General* [1991] BCLC 476).

¹¹ *Ibid*, p 2,856 (citing *Re Yue Hing Co Ltd* (1915) 10 HKLR 32, on appeal (1916) 11 HKLR 53, 82).

¹² For example, a company doing any of the following: reducing the number of its members below two (Companies Ordinance, s 177(1)(c); throughout a period of at least six months leading up to the date of a winding-up petition, nor having at least two directors, or a secretary (*ibid*, s 177(2)(b) & (c)); or failing to pay its annual company registration fee (*ibid*, s 177(2)(d)).

- (e) without prejudice to paragraphs (a) to (d) [of s 177(2)], that the company has been persistently in breach of its obligations under this Ordinance.

Ability of the Financial Secretary to petition for the winding up of companies under the Companies Ordinance

Section 179(1)(d) of the Companies Ordinance provides that the Financial Secretary may present a winding-up petition in a case falling within s 147(2)(a) of the Companies Ordinance. Section 147(2) sets out when the Financial Secretary may petition for relief and provides as follows :

If, in the case of any body corporate liable to be wound up under this Ordinance, it appears to the Financial Secretary from a report made [by an inspector appointed to investigate the affairs of a company] under section 146 [of the Companies Ordinance] or from any information or document obtained under Section 152A¹³ or 152B¹⁴ [of the Companies Ordinance]—

- (a) that it is expedient in the public interest that the body should be wound up, he may present a petition for it to be wound up if the court thinks it just and equitable for it to be so wound up;
- (b) that the business of such body corporate is being or has been conducted in a manner unfairly prejudicial to the interests of the members generally or of any part of its members, he may (in addition to, or instead of, presenting a petition under paragraph (a)) present a petition for an order under section 168A [of the Companies Ordinance].¹⁵

Pursuant to ss 142 and 143 of the Companies Ordinance, the Financial Secretary may appoint an inspector to investigate the affairs of a company and to report thereon. Section 143(1)(c) provides that the Financial Secretary may appoint an inspector (or inspectors)¹⁶ if it appears to the Financial Secretary that there are circumstances suggesting—

- (i) that the business of the company has been or is being conducted with intent to defraud its creditors or the creditors of any other person or otherwise for a fraudulent or unlawful purpose or in a manner oppressive of any part of its members or that it was formed for any fraudulent or unlawful purpose; or

¹³ Pursuant to the power of the Financial Secretary to require the production of documents.

¹⁴ Pursuant to a warrant issued by a magistrate.

¹⁵ Section 168A is an alternative remedy to winding up that may be used in cases in which it is alleged that the affairs of the company are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or to some part of the members. For further discussion of this issue, see Tomasic & Tyler (note 10 above), paras [8252-8501], pp 2,407-2,605.

¹⁶ Section 143(2) provides that this power shall be exercisable by the Financial Secretary with respect to a company regardless of whether the company is in the course of being voluntarily wound up.

- (ii) that persons concerned with the formation or the management of its affairs have in connexion therewith been guilty of fraud, misfeasance or other misconduct towards it or towards its members; or
- (iii) that its members have not been given all the information with respect to its affairs that they might reasonably expect.¹⁷

An additional advantage of appointing an inspector is that an inspector may examine witnesses who are involved in the case.¹⁸ Inspectors were appointed to investigate the affairs of the Allied Group and the World Trade Centre Group in the early 1990s. Recently, an inspector was also appointed to investigate the collapse of Peregrine Investments Holdings Ltd and Peregrine Fixed Income Ltd. Since the companies were already in the process of being compulsorily wound up, the inspector was appointed by the Financial Secretary pursuant to a court order.¹⁹

To summarize, the Financial Secretary may only petition under s 179(1)(d) of the Companies Ordinance in cases where it appears to the Financial Secretary (i) from an inspector's report under s 146 or (ii) from any information or document obtained under s 152A or 152B, that it is 'expedient in the public interest' for the company to be wound up. It will then be a matter for the court to determine whether it is just and equitable for the company to be wound up. An example of a case in which companies were wound up on the petition of the Financial Secretary filed after an investigation was conducted is *First Bangkok City Finance Ltd & Anor v Coro Tejaipabui & Ors*.²⁰ The Financial Secretary had asserted that seven Thai nationals ran two deposit-taking companies for their own benefit and diverted the companies' funds into other companies that they wholly or partly owned or into accounts that were in the name of their families or associates.

Ability of the Securities and Futures Commission to petition for the winding up of listed companies under the Securities and Futures Commission Ordinance and of licensed leveraged foreign exchange traders under the Leveraged Foreign Exchange Trading Ordinance

¹⁷ Section 143(1) also provides for the appointment of an inspector (or inspectors) by the Financial Secretary pursuant to a court order (sub-s (a)) or to a corporate special resolution (sub-s (b)). Unlike an appointment pursuant to sub-s (b) or (c), where a court order is made under sub-s (a), the appointment is mandatory.

¹⁸ More particularly, a person who 'is or may be in possession of any information concerning [the company's] affairs'. Companies Ordinance, s 145(1A). See also *ibid*, s 145(2A).

¹⁹ See *Financial Secretary v Peregrine Investments Holdings Ltd (in liq) & Ors* [1999] 2 HKLRD 691 (22 April 1999) (granting a declaration under s 143(1)(a) that the affairs of Peregrine Investments Holdings Ltd and Peregrine Fixed Income Ltd ought to be investigated by an inspector or inspectors appointed by the Financial Secretary). The SFC had also investigated the collapse of Peregrine and referred the matter to the government after determining that it had 'insufficient power to conduct the investigation'. See Enoch Yiu, 'Independent Peregrine crash probe considered', *South China Morning Post (Business Post)*, 24 June 1998, p 1. Unlike an inspector, the SFC was not able to examine witnesses. See text accompanying notes 47-48 below.

²⁰ [1989] 1 HKC 453.

The Securities and Futures Commission Ordinance empowers the SFC to regulate the dealing in securities and trading in futures contracts of listed companies. Section 45(1) of the Securities and Futures Commission Ordinance provides that in the case of a listed company that may be wound up by the Court of First Instance under the Companies Ordinance, where it appears to the SFC 'that it is expedient in the public interest that the company should be wound up', the SFC may (subject to sub-s (2)) present a petition for the company to be wound up under the Companies Ordinance on the ground that it is 'just and equitable' that the company should be so wound up. Section 59 of the Leveraged Foreign Exchange Trading Ordinance provides similarly in the case of a leveraged foreign exchange trader, requiring that it must appear to the SFC that 'it is expedient in the interest of the investing or general public' that the limited company should be wound up.

Once a petition is presented by the SFC under s 45(1) or 59 of the respective ordinance, the court has the power to wind up the company,²¹ regardless of whether the company is insolvent.²² This statutory approach of ss 45 and 59 is analogous to the approach noted above under s 179 of the Companies Ordinance in cases commenced on a public interest petition by the Financial Secretary — first, the SFC must determine whether it is expedient in the public interest (or, more particularly, in the interest of the investing or general public under s 59) for the company to be wound up, and then the court must decide whether it is just and equitable for the company to be so wound up. However, there are some important differences from the s 179 procedure. Unlike s 179, ss 45 and 59 do not require that an investigation of the company has occurred or that the SFC must rely on information or documents obtained in accordance with statutory procedures. Also, pursuant to s 45(2), the SFC may not petition under sub-s (1) for the winding up of any 'person' that is a member of a Stock or Futures Exchange Company or a clearing house, without first providing written notification to the Company or the clearing house, as the case may be.²³ There is no such notification requirement for any company under s 179.

²¹ *Securities and Futures Commission v Mandarin Resources Corp Ltd & Anor*, Companies Winding-Up No 348 of 1996 (Court of First Instance, 19 November 1999), at 6 (*Mandarin Resources IV*), <http://www.smlawpub.com.hk/Alerts/cases/1999/Nov/Q348C96.htm>.

²² See *Securities and Futures Commission v Mandarin Resources Corp Ltd & Anor* [1997] 1 HKC 214, 225 G (*Mandarin Resources I*) (noting that 'it would be remarkable if solvent companies were immune from public interest petitions. That is not what the Ordinance indicates.').

²³ There is no equivalent in s 59 of the Leveraged Foreign Exchange Trading Ordinance. Section 46 of the Securities and Futures Commission Ordinance provides that the SFC may file a 'public interest' petition against a 'registered person' under the Bankruptcy Ordinance (cap 6) if grounds exist for a creditor to present such a petition. Section 2 of the Securities and Futures Commission Ordinance defines a registered person as a person who is registered under the Securities Ordinance (cap 33) or the Commodities Trading Ordinance (cap 250) (or both) as 'a dealer, dealing partnership, dealer's representative, investment adviser, commodity trading adviser, investment advisers' partnership, investment representative or a commodity trading adviser's representative'. Similarly, s 60 of the Leveraged Foreign Exchange Trading Ordinance provides that the SFC may petition under the Bankruptcy Ordinance against a 'licensed representative' of a licensed leveraged foreign exchange trader where it appears to the SFC 'that it is expedient in the interest of the investing or general public to do so'.

The court must make an independent determination that the company should be wound up. In a recent interpretation of s 45, the Court of First Instance stated that in deciding whether to make a winding-up order, a court must be 'satisfied by the evidence before it and not on the material which the SFC considered'.²⁴ In reaching this decision, the court noted the need to balance the 'possibly conflicting interests and wishes of the petitioner and those of the independent minority and the investing public as a whole'²⁵ and relied heavily on *Re Walter L Jacob & Co Ltd*,²⁶ where the court stated:

The Court's task ... is to carry out the balancing exercise described above having regard to all the circumstances as disclosed by the totality of the evidence before the court Thus where the reasons put forward by the petitioner are founded on considerations of public interest, the court, if it is to discharge its obligation to carry out the balancing exercise, must itself evaluate those reasons to the extent necessary for it to form a view on whether they do afford sufficient reasons for making a winding up order in a particular case.²⁷

The difficulty of determining the meaning of the phrase 'in the public interest' has been the subject of recent commentary.²⁸ Given that public interest petitions may only be filed by government officials or regulatory authorities, part of whose mandate includes protecting the interest of the public from wrongful actions committed by entities subject to their supervision or regulation, it would seem that inherent in the phrase is some notion of furthering the public good and of protecting society generally.²⁹ In a given case, however, the determination of the matter will depend on the specific facts at issue. Recent liquidations commenced by the SFC on s 45 petitions have involved MKI Corp Ltd,³⁰ Mandarin Resources Corp Ltd ('Mandarin

²⁴ *Mandarin Resources IV* (note 21 above), p 7.

²⁵ *Ibid.*

²⁶ (1989) 5 BCC 244.

²⁷ *Mandarin Resources IV* (note 21 above), p 7 (quoting *Re Walter L Jacob & Co Ltd* (note 26 above), p 251).

²⁸ See, eg, Andrew Keay, 'Public Interest Petitions' (1999) 20(9) *The Company Lawyer* 296, 299.

²⁹ See *ibid* (suggesting that "in the public interest" means something that is in the interest of society as a whole, as opposed to specific sectors of the community or certain people, such as creditors, who are interested in the company which is the subject of the petition.)

³⁰ See *Securities and Futures Commission v MKI Corp Ltd* [1995] 2 HKC 79 (MKI I); *Re MKI Corp Ltd* [1995] HKLY 180 (25 October 1995) (MKI II). MKI, incorporated in Bermuda, had established a place of business in Hong Kong and was an overseas company that had registered under Part XI of the Companies Ordinance. The SFC petitioned under s 327 of the Companies Ordinance to wind up MKI as an unregistered company under Part X of the Companies Ordinance. The High Court held that an overseas company may be wound up under s 327 irrespective of whether it has registered under Part XI of the Ordinance. For further discussion of this case, see Booth, 'Living in Uncertain Times' (note 7 above), pp 407-14. The holding from this case has since been incorporated into s 326(2) of the Companies Ordinance through a statutory amendment, the Companies (Amendment) Ordinance 1997 (3 of 1997), s 48(b), commencing 10 February 1997.

Resources'),³¹ Forlux Securities, the CA Pacific Group, and the Ming Fung Group. These cases prove instructive:

- **MKI Corp Ltd** — This was the first listed company that the SFC petitioned to wind up under s 45. The SFC suspected that the directors of MKI had misled the public (eg, by releasing misleading information) and committed fraud (eg, by siphoning money out of the company).³² The High Court later noted that MKI:
had been used to dupe the public. The shares had been artificially boosted with false information and at the same time money was at best frittered away in imprudent deals and more likely siphoned out of the Company with unscrupulous deals and all the time the Company was giving the impression it was being run by its directors when in fact they were acting as fronts for a person who had good reason to distance himself and be seen to distance himself from the company.³³
- **Mandarin Resources** — The SFC petitioned under both s 45 and s 37A³⁴ of the Securities and Futures Commission Ordinance seeking a number of remedies including redress for the minority shareholders of Mandarin Resources and/or the winding up of the company, based on a complicated series of transactions perpetrated by Chim Pui-chung (the majority shareholder of Mandarin Resources through nominees or companies controlled by Chim) to extract for his personal benefit the major asset of Mandarin Resources, as well as on Chim's alleged violation of takeover and listing rules and company and security laws.³⁵
- **Forlux Securities** — The brokerage ceased operating after its director and 99% shareholder disappeared. The police classified the case as one involving conspiracy to defraud and the SFC intervened 'for the protection and preservation of the assets of Forlux, and to facilitate the orderly return of assets to clients'.³⁶
- **CA Pacific Group** — The SFC filed petitions against members of the group after it became apparent that client assets 'may not have been adequately protected'.³⁷ Clients alleged that without their knowledge,

³¹ See *Mandarin Resources I* (note 22 above); *Securities and Futures Commission v Mandarin Resources Corp Ltd & Anor* [1997] 2 HKC 166 (*Mandarin Resources II*); *Securities and Futures Commission v Mandarin Resources Corp Ltd & Anor* [1997] HKLY 192 (26 June 1997) (*Mandarin Resources III*); *Mandarin Resources IV* (note 21 above).

³² *MKI II* (note 30 above).

³³ *Ibid.*

³⁴ Discussed below in text accompanying notes 40-45.

³⁵ See *Mandarin Resources I* (note 22 above).

³⁶ 'Forlux Securities Will Be Liquidated', *Asian Wall Street Journal*, 8 May 1998, p 5 (quoting the SFC).

³⁷ *Securities and Futures Commission, Annual Report 97/98* (Hong Kong: Securities and Futures Commission, 1998), paras 2.61-.62, pp 29-30 & para 6.17, p 59.

their shares, which had been held in cash accounts at CA Pacific Securities, had been transferred to margin accounts at CA Pacific Finance where they were used as collateral and later sold by banks when CA Pacific Finance had been unable to pay its debts.³⁸

- Ming Fung Group — It was alleged that after the managing director of Ming Fung suffered large personal losses in futures trading, he used client funds to cover his losses. It was also alleged that many clients' securities were missing.³⁹

As can be seen from discussion of *Mandarin Resources* above, the SFC may also petition against a listed company under s 37A of the Securities and Futures Commission Ordinance. Section 37A provides the SFC with an alternative remedy in cases where 'the affairs of a listed company are being or have been conducted in a manner unfairly prejudicial to the interests of its members generally or of some part of the members'. Thus, unlike the s 45 public interest ground, which focuses on the interest of the public and society generally, s 37A is concerned with the treatment of actual members of the company. Pursuant to s 37A(1), the SFC, after consultation with the Financial Secretary, may make an application to the Court of First Instance by petition for an order under the section.⁴⁰ Sub-section (2) provides as follows:

If on a petition under this section the court is of the opinion that the company's affairs are being or have been conducted in a manner unfairly prejudicial to the interests of its members generally or of some part of the members, whether or not the conduct consists of an isolated act or a series of acts, the court may, with a view to bringing to an end the matters complained of —

- (a) make an order restraining the commission of the act or conduct;
- (b) order that such proceedings as it may think fit shall be brought in the name of the company against the persons, and on the terms, that it orders;
- (c) appoint a receiver or manager of the whole or a part of the company's property or business and may specify the powers and duties of the receiver or manager and fix his remuneration;

³⁸ Lana Wong, 'Fraud inquiry looms for CAP Group units', South China Morning Post (Business Post), 22 January 1998, p 3.

³⁹ Enoch Yiu, 'Exchange in tough stance on scandals', South China Morning Post (Business Post), 27 May 1998, p 3.

⁴⁰ Unlike s 45, s 37A requires that for the SFC to file a petition, the supporting information, record or other document must have been obtained under s 29A of the Securities and Futures Commission Ordinance (which gives the SFC the power of investigation), or under s 36 in relation to s 29A (pursuant to a magistrate's warrant). These requirements are similar to the requirements for the Financial Secretary under the Companies Ordinance when filing a public interest petition. See text accompanying notes 13-14 above.

- (d) make any other order it thinks fit, whether for regulating the conduct of the company's affairs in future, or for the purchase of the shares of any members of the company by other members of the company or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise.⁴¹

In earlier litigation involving Mandarin Resources, the Court of Appeal found that s 37A includes a power to wind up a listed company.⁴²

The Court of First Instance has noted that in interpreting s 37A(2), before deciding what relief, in any, should be granted, the court must be satisfied that the following four ingredients have been proved: (1) that the affairs of the company have been or are being conducted in a manner ...; (2) that the conduct is prejudicial to the company's members or part of them; (3) that the prejudice is unfair prejudice; and (4) that the unfair prejudicial conduct affects the members' interests.⁴³

In a given case, the SFC may petition under both s 45 and s 37A, as it did in regard to Mandarin Resources. Only recently, the Court of First Instance ruled on the s 37A issues involved in that case and held that the affairs of Mandarin Resources in fact 'are being and have been conducted in a manner unfairly prejudicial to the interests of the minority shareholders' and ordered Mr Chim (whom it found was in control of the company and, although not a registered shareholder, was the beneficial owner of the majority of the company's shares) to purchase the shares of the independent minority shareholders at a fair value.⁴⁴ It also directed that Mr Chim be declared unfit to hold a management position in Mandarin Resources and be disqualified from acting as a director.⁴⁵

The Securities and Futures Commission Ordinance provides the SFC with a variety of other powers to investigate fraudulent or unlawful activity by a listed company or its directors, which might well lead to the discovery of information upon which a s 45 or 37A petition could be based. For example, in certain defined situations, s 29A(1) empowers the SFC to require the production of specified records and documents from a company, its subsidiaries, or any company substantially under the control of the same person as the company. Additional powers exercisable by the SFC under s 29A include the following: requesting records and documents from any person who appears to be in possession of them (sub-s (3)); and requiring a person (including a present

⁴¹ As noted by the court in *Mandarin Resources IV* (note 21 above), p 4, these provisions are almost identical to the provisions appearing in s 168 of the Companies Ordinance, with the only difference being that under s 37A the petition must be filed by the SFC.

⁴² *Mandarin Resources III* (note 31 above).

⁴³ *Mandarin Resources IV* (note 21 above), p 4.

⁴⁴ *Ibid*, p 61. See also *Mandarin Resources I* (note 22 above).

⁴⁵ *Mandarin Resources IV* (note 21 above), p 61. See also *Mandarin Resources I* (note 22 above), p 223.

or past officer) to provide an explanation of them (sub-s (4)(a)(ii)) and to verify the explanation by statutory declaration (sub-s (8)). Pursuant to sub-s 10, in a case involving an authorized institution as defined under the Banking Ordinance, the SFC's power to give directions regarding the production of records and documents may only be exercised in respect of the circumstances specified in sub-s (1)(c) or (1)(d) (with some further limitations).

Section 30 provides the SFC with power to ascertain whether a 'registered person'⁴⁶ under the Ordinance has complied with any provision of, or any requirement under, the relevant Ordinance or the terms and conditions of any certificate of registration. This is accomplished by granting the SFC in certain defined circumstances the right to enter the premises of the registered person and to inspect and make copies of any record or document. Section 31 empowers the SFC to require from certain persons information relating to transactions involving securities or futures contracts. Section 32, in turn provides that if a person, without reasonable excuse, fails to comply with s 29A, 30, or 31, the SFC may certify the failure to the Court of First Instance and the Court of First Instance may ultimately hold the person in contempt of court.

Section 33(1) provides detailed guidelines as to the ability of the SFC to investigate alleged offences including (under sub-s (b)) the commission of a 'defalcation or other breach of trust, fraud, or misfeasance' —

- (i) in dealing in securities or trading in future contracts;
- (ii) in the management of investment in securities or in futures contracts;
- (iii) in making property investment arrangements; or
- (iv) in giving advice as regards the acquisition, disposal, purchase or sale, or otherwise investing in, any security or futures contract or as regards any property investment arrangements.

Section 36 provides that the SFC may seek a magistrate's warrant to assist with the compliance of s 29A, 30, or 33 of the Ordinance. Sections 39, 40, and 41 provide the SFC (in defined circumstances) with powers regarding the restriction of business, the restriction on dealing with assets, and the maintenance of assets.

One weakness of the SFC's investigatory powers is the inability of the SFC to question certain third parties, which was evident in the SFC's investigation into the collapse of Peregrine Investments Holdings.⁴⁷ This matter is likely to be addressed in the proposed Composite Securities and Futures Bill.⁴⁸

⁴⁶ See note 23 above. See also ss 41-55 of the Leveraged Foreign Exchange Trading Ordinance with respect to powers of investigation and intervention against a licensed leveraged foreign exchange trader.

⁴⁷ See note 19 above.

⁴⁸ See text accompanying notes 77-82 below.

The ability of the Financial Secretary to petition for the winding up of 'authorized institutions' under the Banking Ordinance

The Banking Ordinance establishes a three-tier structure for regulating authorized deposit-taking institutions, which are called 'authorized institutions'. Section 2 of the Banking Ordinance sets out the following three tiers of authorized institutions: (1) banks (licensed banks); (2) restricted licence banks; and (3) deposit-taking companies.

Authorized institutions may operate in Hong Kong as companies incorporated in Hong Kong or as branches of foreign banks. Licensed banks have the greatest amount of flexibility in their operations, for they may establish current accounts and accept any deposit (regardless of its size or maturity). Restricted licence banks may only take deposits (of any maturity) greater than or equal to HK\$500,000 and are primarily engaged in activities related to merchant banking and capital markets. Deposit-taking companies may only take deposits greater than or equal to HK\$100,000 (with an original term to maturity of at least three months) and often engage in consumer finance and securities activities.⁴⁹ The authorisation criteria for authorized institutions 'seek to ensure that only fit and proper institutions are entrusted with public deposits'.⁵⁰

The Hong Kong Monetary Authority (the 'HKMA') is the government authority responsible for maintaining monetary and banking stability in Hong Kong and for supervising and monitoring authorized institutions. Authorized institutions must comply with a variety of obligations, including, for example, maintaining capital adequacy and liquidity ratios,⁵¹ submitting periodic returns to the HKMA,⁵² and complying with the limitations on loans by and interests of authorized institutions.⁵³

Part X of the Banking Ordinance sets out various powers of control that may be exercised over authorized institutions. Section 52 provides that the HKMA, after consultation with the Financial Secretary, may exercise certain powers under the following conditions:

(1) Where—

- (a) an authorized institution informs the Monetary Authority—
 - (i) that it is likely to become unable to meet its obligations; or
 - (ii) that it is insolvent or about to suspend payment;
- (b) an authorized institution becomes unable to meet its obligations or suspends payment;
- (c) the Monetary Authority is of the opinion that —

⁴⁹ Financial Services website at <http://www.info.gov.hk/fsb/fs/content.htm>.

⁵⁰ *Ibid.*

⁵¹ See Banking Ordinance, Parts XVII & XVIII.

⁵² *Ibid.*, Part XII.

⁵³ *Ibid.*, Part XV.

- (i) an authorized institution is carrying on its business in a manner detrimental to the interests of —
 - (A) its depositors or potential depositors;
 - (B) its creditors; or
 - (C) holders or potential holders of multi-purpose cards [a type of stored-value card] issued by it or the issue of which is facilitated by it ;
- (ii) an authorized institution is insolvent or is likely to become unable to meet its obligations or is about to suspend payment;
- (iii) an authorized institution has contravened or failed to comply with any of the provisions of the Banking Ordinance; . . .
- (d) the Financial Secretary advises the Monetary Authority that he considers it in the public interest to do so[.]

These powers include the power to impose restrictions on an authorized institution in relation to its affairs, business, and property;⁵⁴ to direct that the institution seek advice from an Advisor appointed by the HKMA;⁵⁵ to appoint a Manager to take control of the affairs, business, and property of an authorized institution;⁵⁶ or to report the circumstances to the Chief Executive in Council.⁵⁷ However, the HKMA shall not exercise the powers under s 52(1) (B) or (C) of the Banking Ordinance in respect of an institution that has been ordered wound up by the Court of First Instance.⁵⁸ In 1998, the HKMA exercised its formal powers under s 52 on two occasions.⁵⁹

Section 55 of the Banking Ordinance provides the HKMA with the power to examine the books, accounts, and transactions of any authorized institution, and s 56 requires the authorized institution to produce its books and accounts during a s 55 examination or investigation. Section 59 authorises the HKMA to require an authorized institution to submit an auditor's report, and the HKMA exercised this power nine times in 1998.⁶⁰

Section 53(1)(iii) of the Banking Ordinance gives the Chief Executive in Council the power 'to direct the Financial Secretary to present a petition to the Court of First Instance for the winding up of the authorized institution or former authorized institution by the Court of First Instance.' This power may be exercised in cases where (a) the HKMA makes a report to the Chief Executive in Council under s 52(1)(D) of the Banking Ordinance; (b) any person appeals

⁵⁴ Ibid, s 52(1)(A).

⁵⁵ Ibid s 52(1)(B).

⁵⁶ Ibid, s 52(1)(C). In respect of an authorized institution incorporated outside Hong Kong, this power may only be exercised in relation to the affairs, business or property of the institution that has a Hong Kong connection. See *ibid*, s 51(3D).

⁵⁷ Ibid, s 52(1)(D).

⁵⁸ Ibid, s 52(3E).

⁵⁹ Hong Kong Monetary Authority, *Annual Report 1998* (Hong Kong: Hong Kong Monetary Authority, 1998), p 44.

⁶⁰ Ibid.

to the Chief Executive in Council under s 132A(1) of the Ordinance against a decision of the HKMA under certain sub-sections in s 52 of the Ordinance; or (c) the Financial Secretary refers a report and his recommendations thereon to the Chief Executive in Council under s 117(5)(c) of the Ordinance.

The Financial Secretary may also petition for the winding up of an authorized institution or a former authorized institution under ss 117(5)(f) and 122(5) of the Banking Ordinance. Section 117(5)(f) provides that the Financial Secretary may petition under s 122(5) of the Banking Ordinance upon receipt of a report prepared by an individual under s 117(2) of the Banking Ordinance. A s 117(2) report is prepared by an individual who has been appointed by the HKMA to conduct an enquiry into the affairs, business, or property of an authorized institution. The HKMA makes such an appointment where it believes that it is in the interest of depositors of such institution or in the public interest to do so.

In windings up commenced pursuant to s 53(1)(iii) or 117(5)(f) of the Banking Ordinance, s 122 of the Ordinance plays an important role. Section 122(1) provides that the creditors' voluntary winding-up provisions in the Companies Ordinance shall not apply to authorized institutions. Section 122(2) provides as follows:

On a petition by the Financial Secretary, acting in accordance with a direction of the Chief Executive in Council under section 53(1)(iii), the Court of First Instance may —

- (a) on any ground specified in section 177 of the Companies Ordinance (Cap. 32); or
- (b) if it is satisfied that it is in the public interest that the authorized institution or former authorized institution should be wound up, order the winding-up of an authorized institution or a former authorized institution in accordance with the provisions of the Companies Ordinance (Cap. 32) relating to the winding-up of companies.

This section is broader than s 45 of the Securities and Futures Commission Ordinance, s 59 of the Leveraged Foreign Exchange Trading Ordinance, and s 179 of the Companies Ordinance, which provide for a court to make a winding-up order on a public interest petition where it is just and equitable to do so. Rather, s 122 provides that the court may either order the winding up where it is in the public interest to do so or may instead rely on any of the general grounds set out in s 177 of the Companies Ordinance.

In addition, s 122 restricts the effect of some of the winding-up provisions in the Companies Ordinance. Section 122(3) includes a deeming provision for cases in which before a petition has been filed for the winding up of an authorized institution (whether or not the petition was filed by the Financial

Secretary) a direction for the appointment of a Manager has been given under s 52(1)(c) of the Banking Ordinance and has continued in force up to the filing of the petition. In such cases, for the purposes of a variety of sections in the Companies Ordinance⁶¹ and notwithstanding the general deeming of s 184(2) of the Companies Ordinance as to when a winding up commences,⁶² the winding up by the Court of First Instance shall be deemed to have commenced at the time the direction was so given. This result would not be self-evident in a case commenced by an ordinary creditor under s 177 of the Companies Ordinance against a company that is an authorized institution (or a former authorized institution) and demonstrates the need for the Companies Ordinance to cross-reference the winding-up provisions in the Banking Ordinance.

Section 122(4) provides that s 182 of the Companies Ordinance (regarding the invalidation of any disposition of the property of a company) shall not apply as against a Manager who has assumed control of an authorized institution, or as against an institution under the direction of the Manager, acting in good faith in the course of managing the affairs, business, and property of the institution.

Section 122(5) provides that where the Financial Secretary is entitled to petition the Court of First Instance by virtue of s 117(5)(f), the Court of First Instance may wind up a deposit-taking company, restricted licence bank, former deposit-taking company, or former restricted licence bank, in accordance with the provisions of the Companies Ordinance, if —

- (a) the institution is unable to pay sums due and payable to its depositors or is able to pay such sums only by defaulting on its obligations; or
- (b) the value of the institution's assets is less than the amount of its liabilities.

Perhaps the most well-known insolvency of a financial institution was the liquidation of the Bank of Credit and Commerce Hong Kong Ltd. On 8 July 1991, the Commissioner of Banking decided to close the bank, and on that same day the Governor in Council directed the Financial Secretary to present a petition to wind up the bank. Nine days later a winding-up petition was filed under s 53(1)(iii) of the Banking Ordinance and the winding up was conducted under the provisions of the Companies Ordinance.⁶³

⁶¹ Namely, ss 170, 179, 182, 183, 266, 267, 269, 274, and 271(1)(d), (e), (h), (i), (j), (k), (l), and (o).

⁶² I.e. at the time of the filing of the winding-up petition.

⁶³ See *Re Bank of Credit and Commerce Hong Kong Ltd*, Companies Winding-Up No 218 of 1991.

The ability of the Insurance Authority to petition for the winding up of insurers under the Insurance Companies Ordinance

The Office of the Commissioner of Insurance is a government office and is responsible for administering the Insurance Companies Ordinance, which governs insurance companies and insurance intermediaries in Hong Kong. The Commissioner of Insurance is appointed the Insurance Authority⁶⁴ by the Chief Executive. Pursuant to s 4A of the Insurance Companies Ordinance, the principal function of the Insurance Authority is to 'regulate and supervise the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policy holders.'

An insurer is defined in s 2 of the Insurance Companies Ordinance as a 'person carrying on insurance business but does not include Lloyd's.' Part VI of the Ordinance, (including ss 42 to 49B) is entitled 'Insolvency and Winding Up'. Section 44 provides the Insurance Authority with the ability to present a winding-up petition against an insurer, and s 44(3) provides that the Insurance Authority may petition if it appears to the Authority that it is 'expedient in the public interest that the company should be wound up' and if the court thinks it 'just and equitable' for the insurer to be so wound up. However, a public interest petition may not be filed where a company is in the process of being wound up.

The Insurance Companies Ordinance, like the Banking Ordinance, provides additional grounds for winding up. Section 44(1)(b) and (c) includes grounds that may be relevant to the winding up of a fraudulent company. This section provides as follows:

The Insurance Authority may present a petition for the winding up, in accordance with the Companies Ordinance (Cap. 32), of an insurer, being a company which may be wound up by the Court under that Ordinance, on the ground —

....

- (b) that the company has failed to satisfy an obligation to which it is or was subject by virtue of this Ordinance or any Ordinance repealed thereby;
or
- (c) that the company, being under the obligation imposed by section 16 [of the Insurance Companies Ordinance] with respect to the keeping or preserving of proper books of account, has failed to satisfy that obligation or to produce books kept in satisfaction of that obligation.

Pursuant to s 44(1)(a), the Insurance Authority may also petition to wind up an insurer on the ground that the company is unable to pay its debts within the meaning of ss 177 and 178 or s 327 of the Companies Ordinance.

⁶⁴ Pursuant to s 4 of the Insurance Companies Ordinance.

The Insurance Companies Ordinance, like the Banking Ordinance, also includes provisions that may restrict the effect of the winding-up provisions in the Companies Ordinance. Section 42(1) of the Insurance Companies Ordinance includes a provision deeming an insurer for the purposes of s 177 or 327 of the Companies Ordinance to be unable to pay its debts if at any time the value of the insurer's assets does not exceed the amount of the insurer's liabilities by the 'relevant amount' as required by s 10 of the Insurance Companies Ordinance. As to the inability of an insurer to pay its debts, s 44(2) includes a rebuttable presumption that on a petition presented by the Insurance Authority under s 44(1), evidence that the company was insolvent at certain defined times⁶⁵ shall be evidence that the company continues to be unable to pay its debts.

Section 44(4) provides that where another person other than the Insurance Authority petitions for the winding up of an insurance company, a copy of the winding-up petition shall be served on the Insurance Authority and the Authority 'shall be entitled to be heard on the petition and to call, examine and cross-examine any witness and, if he so thinks fit, support or oppose the making of the winding up order.' However, breach of s 44 does not entitle the Insurance Authority to a winding-up order as a matter of course; rather, because the jurisdiction to wind up the company is exercisable under s 177 or 327 of the Companies Ordinance, the court has an overriding discretion.⁶⁶

Section 43 provides that the Court of First Instance may order the winding up of an insurer in accordance with the provisions of the Companies Ordinance, with the additional proviso that an insurer may be wound up on the petition of ten or more policy holders with the leave of the court. However, the section further provides that such a petition shall not be presented except by leave of the court, and for leave to be granted a *prima facie* case will have to be established to the satisfaction of the court and security for costs must be given. Lastly, s 45 provides, *inter alia*, that an insurer shall not be wound up voluntarily unless the court otherwise orders, and that in such cases the Insurance Authority shall play the same respective role as that set out in s 44(4) in winding-up cases commenced by another person.⁶⁷

⁶⁵ Namely:

- at the close of the period to which the accounts and balance sheet of the company last deposited under s 20 [of the Insurance Companies Ordinance] relate; or
- at any date or time specified in a requirement under s 32 or 34 [of the Insurance Companies Ordinance].

⁶⁶ See Tomasic & Tyler (note 10 above), para [9251], at 2,857 (citing *Re Armour Insurance Co Ltd* [1993] 1 HKLR 179).

⁶⁷ Other relevant provisions in the Insurance Companies Ordinance are as follows: s 46 applies to the continuation of the long-term business of an insurer in liquidation; s 47, to the winding up of insurers involved in a transfer of business; s 48, to the reduction of contracts as an alternative to the winding up of an insurer; s 49, to the making of winding-up rules under s 296 of the Companies Ordinance; s 49A, to the winding up of an insurer subject to a direction under s 35(2)(b) of the Insurance Companies Ordinance that a Manager be appointed to manage the affairs business and property of an insurer; and s 49B, to the requirements of providing notice to the Insurance Authority of the commencement of a liquidation, of the appointment of a provisional liquidator or liquidator, and of other matters.

Law Reform Proposals

The Companies Ordinance does not at present make reference to the ability of regulatory authorities or the Financial Secretary to petition under other legislation for the winding up of certain companies. The Law Reform Commission of Hong Kong Sub-Committee on Insolvency (the 'Sub-Committee on Insolvency') concluded that although it was not necessary to cross-reference the provisions that enable regulatory authorities to wind up companies, it would be useful for the Companies Ordinance to mention these powers. Therefore, in its *Consultation Paper on the Winding-Up Provisions of the Companies Ordinance*, the Sub-Committee proposed that a new s 177(1)(g) be added to the Companies Ordinance to note that regulatory authorities have powers to wind up companies.⁶⁸ In its *Report on the Winding-Up Provisions of the Companies Ordinance*,⁶⁹ the Law Reform Commission of Hong Kong (the 'Law Reform Commission'), in turn, recommended adoption of this statutory change. The Law Reform Commission also noted a submission suggesting an alternative — namely, that a schedule containing all of the bases enabling the regulatory authorities to wind up a company should be inserted in the proposed Insolvency Ordinance — and suggested that the matter be left to the Law Draftsman.⁷⁰

Neither the *Consultation Paper on the Winding-Up Provisions of the Companies Ordinance* nor the *Report on the Winding-Up Provisions of the Companies Ordinance* addressed in any detail the issues involving regulatory authorities or government officials filing winding-up petitions that are based on non-insolvency grounds. Nor did they discuss the effect of the Banking Ordinance and the Insurance Companies Ordinance on the application of certain winding-up provisions in the Companies Ordinance in liquidations of authorized institutions or insurers. This is because the statutory review by both the Law Reform Commission and the Sub-Committee on Insolvency focussed, with but few exceptions, on the provisions of the Companies Ordinance. However, the issues involving the filing of petitions by regulatory authorities and government officials, as well as the issues involving the winding up of authorized institutions and insurers under the Companies Ordinance, require a more detailed consideration of the interaction among the various pieces of legislation.

Both the Sub-Committee on Insolvency and the Law Reform Commission are correct in proposing the need to give notice in the winding-up legislation of the other statutory powers to wind up a company in Hong Kong. However, I would suggest that it is insufficient merely to add a new section recording that regulatory authorities have the power to wind up companies. It would be better

⁶⁸ Law Reform Commission of Hong Kong Sub-Committee on Insolvency, *Consultation Paper on the Winding-Up Provisions of the Companies Ordinance* (Hong Kong: Printing Department, April 1998), para 4.3, p 13.

⁶⁹ Law Reform Commission of Hong Kong, *Report on the Winding-Up Provisions of the Companies Ordinance* (Hong Kong: Printing Department, July 1999), para 9.3, p 35.

⁷⁰ *Ibid.* See text accompanying note 71 below.

to add either a schedule or a separate provision setting out all the bases in the Securities and Futures Commission Ordinance, the Leveraged Foreign Exchange Trading Ordinance, the Banking Ordinance, and the Insurance Companies Ordinance that enable the Financial Secretary and regulatory authorities to file winding-up petitions. This would be a more comprehensive way of addressing the existing statutory omission.

I would also suggest that other amendments are necessary. As can be seen from the discussion above of the Banking Ordinance and the Insurance Companies Ordinance, certain sections limit the effect of the winding-up provisions in the Companies Ordinance in liquidations involving authorized institutions and insurers. Some of these provisions, such as s 122 of the Banking Ordinance and ss 42 to 44 of the Insurance Companies Ordinance, also apply to liquidations that have not been commenced by the Financial Secretary or the Insurance Authority. These provisions should be cross-referenced in the Companies Ordinance. The Law Reform Commission has recommended that a separate Insolvency Ordinance be established to include all forms of winding up, receivership, provisional supervision, and bankruptcy.⁷¹ Eventually, this proposed legislation should incorporate all the provisions in the Securities and Futures Commission Ordinance, the Leveraged Foreign Exchange Trading Ordinance, the Banking Ordinance, and the Insurance Companies Ordinance that relate to insolvency.

In its *Report on Corporate Rescue and Insolvent Trading*, the Law Reform Commission recommended the enactment of a comprehensive corporate rescue procedure called provisional supervision,⁷² which was recently gazetted in Part IVB of the Companies (Amendment) Bill 2000.⁷³ The Law Reform Commission proposed that provisional supervision should not be imposed on certain regulated industries including banking, insurance, securities and futures, and leveraged foreign exchange trading,⁷⁴ and this recommendation was incorporated in the recently gazetted bill into proposed s 168V(1)(b) of the Companies Ordinance.⁷⁵ The Law Reform Commission's rationale was that

⁷¹ See *ibid*, ch 2.

⁷² Law Reform Commission of Hong Kong, *Report on Corporate Rescue and Insolvent Trading* (Hong Kong: Government Printer, October 1996).

⁷³ 7 January 2000 (LS No 3 to Gazette no 1/2000).

⁷⁴ *Report on Corporate Rescue and Insolvent Trading* (note 72 above), paras 2.12-.23, pp 22-5. For a discussion of the Law Reform Commission's recommendations regarding provisional supervision, see Charles D Booth, 'Hong Kong Corporate Rescue Proposals: Making Secured Creditors More Secure' (1998) 28 Hong Kong Law Journal 44.

⁷⁵ Pursuant to Companies (Amendment) Bill 2000, s 24. Proposed s 168V(1)(b) provides that subject to proposed s 168ZD(10), provisional supervision does not apply to these regulated businesses. Proposed s 168ZD(10) provides that the government in its capacity (if any) as a creditor of a company is bound by proposed Part IVB of the Companies Ordinance, without prejudice to the operation of proposed s 168ZD(4), which sets out exemptions from the moratorium in a provisional supervision. Included in s 168ZD(4) is, *inter alia*, an exemption for 'any proceedings or other legal process in relation to the performance of any function or the exercise of any power under s 29A, 30, 31, 33, 37A or 45 of the Securities and Futures Commission Ordinance'. Thus, it would appear that the effect of these proposals is that although the government, in its capacity as a creditor of a company, will be bound by the moratorium of a company in the midst of provisional supervision, the SFC will

regulatory bodies in charge of these industries should consider whether to apply 'a remedial procedure through their own legislation.'⁷⁶ This is a sensible approach, for such matters are best left to the regulators.

Lastly, the powers of the SFC are in the process of being reviewed and are likely to be expanded in the proposed Composite Securities and Futures Bill. At present, nine different ordinances (plus parts of the Companies Ordinance) govern the securities and futures industry.⁷⁷ The proposed bill, which is expected to be tabled by the Legislative Council in mid-2000, will dramatically overhaul the existing framework. Among the expected changes will be to further strengthen the SFC's authority and powers in many ways, including the following:

- to expand the SFC's regulatory authority to include electronic trading systems;⁷⁸
- to widen the SFC's investigatory powers, including giving the SFC greater breadth in its enquiries with parties that have contractual relationships with listed companies,⁷⁹ and enabling the SFC to more easily access the banking records of listed companies⁸⁰ and the working papers of a listed company's auditors;⁸¹ and
- to increase sanctions.⁸²

By expanding the scope of the SFC's investigatory powers, the proposed Composite Securities and Futures Bill will increase the likelihood that the SFC will be able to intervene against listed companies with s 45 and 37A petitions at an earlier stage than is possible at present.

nevertheless be able to file an unfair prejudice or public interest petition against such a company. However, there is nothing in proposed s 168ZD(10) and (4) that addresses whether a regulated company may be made subject to provisional supervision. Thus, it is unclear why the exemption of regulated industries from provisional supervision was made subject to proposed s 168ZD(10).

Proposed s 168V(1)(a) and (2)(a) provides that provisional supervision shall apply to a class of companies declared in a notice issued in the *Gazette* by the Secretary for Financial Services to be a class of companies to which provisional supervision shall apply. But there is nothing in proposed s 168V that makes the exemption of regulated companies in sub-s (1)(b) subject to such a declaration by the Secretary for Financial Services. Since there is no mechanism in s 168V for resolving such a dispute, if the Secretary for Financial Services declared, for example, that banks were a class of companies to which provisional supervision applied, that declaration would be in conflict with proposed s 168V(1)(b)(i), which exempts banks.

These issues will have to be resolved before the bill is enacted into law.

⁷⁶ *Report on Corporate Rescue and Insolvent Trading* (note 72 above), para 2.12, p 22.

⁷⁷ Securities and Futures Commission, *Overview Guide to The Proposed Securities and Futures Bill* (5 July 1999), p 4, SFC website at <http://www.hksfc.org.hk/eng/index.htm>.

⁷⁸ *Ibid*, p 13.

⁷⁹ *Ibid*, p 18.

⁸⁰ *Ibid*.

⁸¹ *Ibid*.

⁸² *Ibid*, pp 16-17. It will be proposed to amend s 37A of the Securities and Futures Commission Ordinance to expand the power of the court 'to disqualify a person who has engaged in misconduct from being a director or otherwise taking part in the management of a corporation.' Securities and Futures Commission, *Guide to Legislative Proposals on Powers of Intervention and Proceedings (to be included in the Securities and Futures Bill)* (5 July 1999), p 3, SFC website (note 77 above). No material changes will be made to s 45 of the Securities and Futures Commission Ordinance. *Ibid*, p 2.

The appointment and role of provisional liquidators in windings up commenced by regulatory authorities and government officials against companies engaged in illegal or fraudulent activities

Pursuant to s 193 of the Companies Ordinance, in a winding up by the court, after the presentation of a winding-up petition, but before the making of a winding-up order, the court may appoint a provisional liquidator. Upon the making of a winding-up order, the Official Receiver becomes the provisional liquidator unless a person other than the Official Receiver has been appointed as provisional liquidator under s 193.⁸³ The provisional liquidator continues to serve until he or another person is appointed liquidator.⁸⁴ Until recently, the practice in liquidations was for private liquidators to be appointed in complicated cases and for the Official Receiver to serve in less-complicated liquidations. However, in May 1996 the Official Receiver introduced a scheme to contract out non-summary court winding-up cases (cases in which the net realisable assets exceed HK\$200,000) and set up an Administrative Panel of Insolvency Practitioners for Court Winding-Up that included firms of accountants (now called the Panel A Scheme). Thus, at present, the practice is for the Official Receiver to serve initially as provisional liquidator. In cases in which there are sufficient assets to justify an appointment from the Panel A Scheme, the Official Receiver will then put forward to the creditors a recommendation of a panel member, in order of rotation, for confirmation as liquidator. The choice is usually accepted, but the creditors may choose another panel member, or even an accountant not on the panel, subject to the discretion of the court.

In general, a provisional liquidator may be appointed prior to the making of a winding-up order where there is evidence that the company's assets are at risk and may disappear if no action is taken to protect them prior to the hearing of the winding-up petition.⁸⁵ There is no provision in the Companies Ordinance that sets out the powers of a provisional liquidator, unlike s 199 of the Ordinance, which sets out the powers of a liquidator.⁸⁶ Rather, the standard practice has been for the court to set out the powers of a provisional liquidator in the order of appointment and for the provisional liquidator to apply to court if he needs additional powers.⁸⁷ To address this inadequacy, the Law Reform Commission has recommended that a schedule be included in the Companies Ordinance that sets out the powers to be exercised by a provisional liquidator.⁸⁸

⁸³ Companies Ordinance, s 194(a), (aa).

⁸⁴ Ibid.

⁸⁵ See Tomasic & Tyler (note 10 above), para [9754], p 3,201; para [9776], p 3,202.

⁸⁶ Report on the Winding-Up Provisions of the Companies Ordinance (note 69 above), para 12.8, p 57.

⁸⁷ Ibid.

⁸⁸ Ibid, paras 12.3-11, pp 56-59.

Given the unusual nature of a petition filed by a regulatory authority or a government official on public interest, unfair prejudice, or other statutory grounds against a company (whether solvent or insolvent) allegedly committing fraud, additional factors are relevant to the appointment of a provisional liquidator. In the litigation arising out of the appointment of provisional liquidators for Mandarin Resources — a case commenced on public interest and unfair prejudice grounds — the Court of Appeal noted that the matter of appointing a provisional liquidator is a matter of discretion that ‘ultimately, depend[s] on the view [the judge] forms as to whether, on the material before him, the balance of justice and convenience’ supports the appointment.⁸⁹ Among the propositions noted by the court in reaching its decision were the following:

- (1) The power of the court to appoint a provisional liquidator, where there is a ‘good prima facie case for a winding up order’ is ‘quite general’; whether or not such an appointment should be made depends on ‘the circumstances of each particular case’ and ‘the public interest’ may be a relevant circumstance.⁹⁰
- (2) The exercise of the power ‘may have serious consequences for the company, and so a need for the exercise of the power must overtop those consequences’; but in the case of a public interest petition, ‘the public interest must be given full weight’.⁹¹
- (3) When, in a ‘public interest’ petition, it is proved or accepted that a fairly arguable case for a winding up order has been shown, and the court is called on to appoint a provisional liquidator, the court, if satisfied that *some* relief is called for in order to ensure that the status quo does not change for the worse before the hearing of the petition, should appoint a provisional liquidator, unless it is also satisfied that that would be a disproportionate remedy, and that the desired result could be achieved by the acceptance of appropriate undertakings or the imposition of appropriate injunctions.⁹²

In a typical insolvency, a provisional liquidator usually serves for a period extending for only a matter of months.⁹³ However, in cases commenced by

⁸⁹ *Mandarin Resources II* (note 31 above), p 171B.

⁹⁰ *Ibid*, p 171D (citing *Re Union Accident Insurance Co Ltd* [1972] 1 All ER 1105, per Plowman J 1109h).

⁹¹ *Ibid*, p 171E (citing *Re Highfield Commodities Ltd* [1984] 3 All ER 884, per Sir Robert Megarry VC at 893b/c).

⁹² *Ibid*, p 71F-H (citing *Re Senator Hanseatische Verwaltungsgesellschaft mbH & Anor* [1996] 2 BCLC 562, especially Sir Richard Scott VC at 596, and (on appeal), [1996] 4 All ER 933 per Millett LJ at 944b-c).

⁹³ According to the Official Receiver’s Office, over the last year the average time period between the filing of a winding-up petition and the making of a winding-up order has ranged from six weeks to two months. From the making of the winding up-order, the appointment of a liquidator often takes up to an additional three months.

government officials or regulatory authorities against fraudulent companies, the time period can extend for much longer. At the upper extreme, the provisional liquidator for Mandarin Resources has already served for almost 3½ years, and it is unclear whether a winding-up order will ever be made in the proceedings against this company.⁹⁴ An appointment for several years may cause difficulties for a provisional liquidator, for an appointment of this length runs counter to the intended limited nature of the office.

In a case commenced by a regulatory authority or a government official against a company allegedly engaging in fraudulent or illegal behaviour, a primary role of the provisional liquidator will be to investigate whether the company had, in fact, committed fraud.⁹⁵ Given both the longer periods of time for which a provisional liquidator may serve in such cases and the need to investigate thoroughly whether the company actually committed fraud, it would be very helpful if the powers exercisable by a provisional liquidator were set out in a schedule to the Companies Ordinance.

Conclusion

The ability of a government official or a regulatory authority to commence liquidation proceedings against a company allegedly engaged in illegal or fraudulent activities through the filing of a petition on public interest, unfair prejudice or other statutory grounds is an important weapon in the government's arsenal for regulating the behaviour of companies in Hong Kong. The following comment, which was made in regard to public interest petitions, is pertinent to all liquidations commenced by regulatory authorities or government officials against companies carrying on fraudulent activities:

It would be unrealistic to believe that such applications or even the threat of them ... will stamp out the evils [involving 'dishonesty or malpractices on the part of ... corporate directors'⁹⁶] They may, however, serve to some extent as a deterrent. Furthermore, particularly in those cases where the involvement of members of the general public is great, the individual victims may stand a better chance of discovering how they were treated and seeing the perpetrators brought to some kind of justice.⁹⁷

⁹⁴ The court in *Mandarin Resources IV* (note 21 above), p 61, found that:

The findings made on the totality of the evidence would justify an order that it is expedient in the public interest that Mandarin [Resources] be wound up and that it is just and equitable to do so. However, the time for such an order has not yet arisen and may never do so.

⁹⁵ Or, perhaps, whether the company had been negligent. For example, when speaking in reference to the liquidation of members of the CA Pacific Group (including CA Pacific Securities), the then SFC Chairman, Anthony Neoh, noted that the provisional liquidators would be investigating whether the company was negligent or had committed fraud. See Wong (note 38 above).

⁹⁶ *Cork Report* (note 1 above), para 1742, p 391.

⁹⁷ *Ibid*, para 1751, p 393.

To increase the likelihood of such petitions having a deterrent effect, there needs to be greater transparency in the legislative framework. At a minimum, either a schedule or a new provision should be included in the Companies Ordinance (and into the successor Insolvency Ordinance) that sets out all the bases in the Securities and Futures Commission Ordinance, the Leveraged Foreign Exchange Trading Ordinance, the Banking Ordinance, and the Insurance Companies Ordinance that enable the Financial Secretary and regulatory authorities to petition for the winding up of companies. The Companies Ordinance should also cross-reference all provisions in these ordinances that affect the application of the winding-up provisions in the Companies Ordinance. Eventually, when a comprehensive Insolvency Ordinance is enacted, it should incorporate all the provisions relating to winding up in these four ordinances.

The effectiveness of these petitions is also influenced by the scope of investigatory powers, both pre- and post-petition. By increasing pre-petition investigatory powers, as the proposed Composite Securities and Futures Bill will likely do with respect to the powers of the SFC, the government increases the likelihood of earlier and more frequent intervention against fraudulent companies through the filing of winding-up petitions. After the filing of such petitions, it is the provisional liquidator who plays the central role in further investigating and uncovering wrongful and fraudulent corporate activities. It would be best for the powers to be exercised by a provisional liquidator to be set out in the Companies Ordinance. The enactment of these proposed changes would further protect the interests of the general public.

*Charles D Booth**

* Associate Professor, Faculty of Law, University of Hong Kong. This article has its origins in papers that the author presented on the Insolvency and Fraud Panel at the International Bar Association Section on Business Law Conference in Copenhagen, Denmark on 14 June 1999 and at the Session of the Insolvency Committee at the Inter-Pacific Bar Association 9th Annual Meeting and Conference in Bangkok, Thailand on 4 May 1999.